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IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 19.6.2006

CORAM

THE HON'BLE MR.JUSTICE P.D.DINAKARAN
AND
THE HON'BLE MR.JUSTICE P.P.S.JANARTHANA RAJA

T.C.(A) Nos.76 to 86, 105, 129 to 133 of 2003 and 287 to 290, 322 to 328 and 459 to 463 of 2006

M/s. Bilahari Investments (P) Ltd
45.Poes Road, I floor, Chennai-18. ... Appellant in TC (A) Nos.76, 77, 81, 82, 83, 84, 129 and 130 of 2003 and 287, 288, 289 and 290 of 2006

M/s. Ranjani Investments
45, Poes Road, I Floor, Chennai78 ... Appellant in TC (A) No's 78, 79 85, 86/03, and 322, 323, 324, 325, 326, 327 and 328 of 2006

M/s. Arabhi Investments (P) Ltd.,
45.Poes Road, I floor, Chennai-18. ... Appellant in TC (A) Nos. 80, 105, 131, 132, 133 of 2003 and 459, 460, 461, 462 and 463 of 2006

Vs

The Commissioner of Income Tax,
Central II, Chennai .. Respondent in TC (A) Nos. 76, 77, 78, 79, 80 81, to 86, 129 to 133

The Assistant Commissioner of
Income tax, Central II, Chennai .. Respondent in TC (A) 105/03

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The Commissioner of Income Tax,
Company Circle, Chennai-31. .. Respondent in TC (A)Nos. 287 to 290/06 322 to 328/06, and 459 to 463/06

T.C. Appeals filed against the order of the Income-tax Appellate Tribunal dated 5.7.2002 made in I.T.A. Nos.2138(Mds)/93, 1793(Mds)/96, 810(Mds)/95, 2073(Mds)/95 and 1361 (Mds)/96.

I dated 5.7.2002 in

1. ITA No.810/MDS/95 for the assessment year 1991-92
2. ITA No.775/MDS/95 for the assessment year 1991-92
3. ITA No.776/MDS/95 for the assessment year 1991-92
4. ITA No.811/MDS/95 for the assessment year 1991-92
5. ITA No.812/MDS/95 for the assessment year 1991-92

TC(A) Nos.76 to 80 of 2003

6. ITA.1361/MDS/96 for the assessment year 1993-94
7. ITA. 1863/MDS/96 for the assessment year 1990-91
8. ITA. 1793/MDS/96 for the assessment year 1990-91
9. ITA. 2073/MDS/95 for the assessment year 1992-93
10. ITA. 2161/MDS/95 for the assessment year 1992-93
11. ITA. 2074/MDS/95 for the assessment year 1992-93

TCA.Nos.81 to 86 of 2003

12. ITA. 1644/MDS/96 for the assessment year 1993-94- TCA/105/03

13. ITA. 2160/MDS/95 for the assessment year 1992-93
14. ITA. 1643/MDS/96 for the assessment year 1993-94
15. ITA. 2075/MDS/95 for the assessment year 1992-93
16. ITA. 774/MDS/95 for the assessment year 1991-92
17. ITA. 2159/MDS/95 for the assessment year 1992-93

TCA Nos. 129 to 133/03

on the file of the Income Tax Appellate Tribunal, Madras Bench B.

II. dated 2.8.05 in ITA No.937/MDS/2000 for the assessment year 1995-96.

ITA. 738/MDS/98 for the assessment year 1994-95
ITA. 1217/MDS/98 for the assessment year 1994-95

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ITA. 1088/MDS/00 for the assessment year 1995-96

TC (A) Nos.287 to 290/06

III dated 2.8.05 in ITA No.1362/MDS/96 for the assessment year 1993-94.

ITA. 1642/MDS/96 for the assessment year 1993-94
ITA. 737/MDS/98 for the assessment year 1994-95
ITA. 1250/MDS/98 for the assessment year 1994-95
ITA. 2012/MDS/98 for the assessment year 1995-96
ITA. 116/MDS/99 for the assessment year 1995-96
ITA. 191/MDS/01 for the assessment year 1997-98

TC (A) Nos. 322 to 328 of 2006

IV dated 2.8.2005 in ITA No.740/MDS/98 for the assessment year 1994-95.

ITA. 1218/MDS/98 for the assessment year 1994-95
ITA. 938/MDS/00 for the assessment year 1995-96
ITA. 1084/MDS/00 for the assessment year 1995-96

respectively on the file of the Income tax Appellate Tribunal Madras A Bench in TC (A) Nos. 459 to 463 of 2006

against the order of the Commissioner of Income tax (Appeals) II, Madras I, dated 1.2.95

1. in Appeal No. 64/94-95 (TC Appeal Nos. 76 to 78 of 2003)
2. in Appeal No.65/94-95 TC (A) No.79/03.
3. in IT /W/appeal No.63/94-95 TC (A) Nos. 80 and 132 of 2003 and 287 to 290 of 2006.

II dated 28.5.1996 in

1. Appeal No.201/96-97 TC (A) No.81/03.
2. Appeal No.199/95-96 TC (A) No.105 and 461 of 2006

III. dated 5.7.96 in

1. Appeal No.200/95-96 TC (A) Nos. 82 adn 83 /2003

IV. dated 2.8.1995 in

1. Appeal No.90/95-96 - TC (A) Nos. 84/03.
129 & 133/03 and 89/95-96 in 131/03.

V. Dated 2.8.1995 in

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1. appeal No.91/95-96 in TC (A) Nos. 85 and 86 of 2003

VI dated 28.5.96 in

1. IT Appeal No.201/95-96 and 198/95-96 in
TC (A) Nos.130/03, 322/06, and 323/06.

VII Dated 27.03.1998 in

1. G.T. Appeal No. 97/98 in TC(A) NOS. 324 & 325/06
2. G.T. Appeal No. 63/97-98 in TC(A) NO 459/06, 460/06 * 325/06
3. G.T. Appeal No. 680/97-98 in TC(A) NOS. 462 and 463/06

VIII Dated 30.10.1998 in

1. IT/WT Appeal No. 50/98-99 in TC(A) NO's 326 and 327/06.

IX. Dated 10.10.2000 in

1. ITA NO. 383/1999-200 TC(A) NO. 328/06
respectively
against the order of the Assistant Commissioner of Income Tax (Central Circle II (6) Madras.

1. Dated 28.07.1994 in PA NO. 47-082-CT -0858
for the assessment year 1991-92 TC(A) NO's 76 to 78 of 2003.

2. Dated 28.07.1994 in PA NO. 47-068-CN-9946 for the assessment year 1991-92 TC(A) NO. 79/03.

3. Dated 28.07.1994 in PA NO. 47-068-CN-9701 for the Assessment year 1991-92 TC (A) NO's 80 and 132 of 2003.

4. Dated 31.01.1996 in PA 47-082-CT-0858 for the assessment years 1993-94 in TC(A) NO's 81/03 and 130/03 and for the assessment year 1990-91 in TC(A) NO's 82 and 83 of 2003.

5. Dated 29.03.1995 in PA 47-082-C40858 for the Assessment year 1992-93 in TC(A) NO. 84/03.

6. Dated 29.03.1995 in PA 47-068-CN-7946 for the Assessment year 1992-93 TC(A) NO's 85 and 86 of 2003.

7. Dated 29.02.1996 in PA 47-068-CN-9701 for the Assessment year 1993-94 TC(A) NO. 105/03.

8. Dated 29.03.1995 in PA 47-082-C4-0858 for the Assessment year 1992-93 TC A No's 129 and 133/03

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9. Dated 29.03.1995 in PA-47-068-CN-9701 for the Assessment year 1992-93 TC(A0 137/03

10. dated 26.02.1998 in PAN/GIR 519-13 for the Assessment year 1995-96 TC(A) NO. 287/06

11. Dated 28.02.1997 in PAN GIR -47-082 -CT-0858 for the Assessment year 1994-95 TC(A) NO. 288/06.

12. Dated 28.02.1997 in PAN/GIR NO. 47-082 CT-0858 for the Assessment year 1994-95 TC(A) 289/06

13. Dated 26.02.1998 in PAN/GIR-519-B for the Assessment Year 1995-96 TC(A) NO. 290/06

14. Dated 31.01.1996 in PAN/GIR NO. 47-068-CN-9946 for the Assessment year 1993-94 TC(A) NO. 322/06

15. Dated 28.02.1997 in PANGIR NO. 47-068-CN 9946 for the Assessment year 1994-95 on the file of the Assistant Commissioner of Income Tax central circle I (4) Chennai - 34 (TC (A) nos. 324 and 325 of 2006.

16. Dated 18.02.1998 in PAN/GIR NO. 47-068 -CN-9946 for the Assessment year 1995-96 on the file of the Deputy Commissioner of Income tax Special Range - IV Chennai 34 TC(A) NO.326 and 327 of 2006.

17. Dated 10.01.2000 in PAN/GIR/NO. 15-R for the Assessment Year 1997-98 on the file of the Joint Commissioner of Income TAx Special Range IV Chenai 34 TC(A) NO. 328/06.

18. Dated 28.02.1997 in PANGIR NO. 47-068-CN-9701 on the file of the Assistant Commissioner of Income Tax Central Circle I (4) Chennai 34 for the assessment year 1994-95 TC(A)No.459 and 460 of 2006.

19. Dated 29.2.1996 in PAN.GIR No. 47-068 CN-9701 on the file of the Assistant Commissioner of Income Tax Central Circle II (6) Chennai 34 for the assessment year 1993-94 TC(A) No. 46/06.

20. Dated 25.2.1996 in PAN.GIR No. 1272-A on the file of the Assistant Commissioner of Income Tax Company Circle IV (1) Chennai 6 for the assessment year 1995-96 TC(A) Nos. 462 and 463/06.

For Appellants in all the cases : Mr.V.D.Gopal

For Respondent in all the cases : Mrs.Pushya Sitaraman
Senior Standing Counsel

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COMMON JUDGMENT
(Delivered by P.D.DINAKARAN, J.)

These appeals arise out of the common order of the Income-tax Appellate Tribunal dated 5.7.2002 made in I.T.A.Nos.2138(Mds)/93, 1793(Mds)/96, 810(Mds)/95, 2073(Mds) /95 and 1361 (Mds)/96, at the instance of three assessees for the assessment years 1990-91, 1991-92, 1992-93 and 1993-94.

2. The brief facts, which are common so far as three various assessees are concerned, giving rise to the above appeals, are as under:-

2.1. The assessees are private limited companies subscribing to chits as their business activity. The assessees were maintaining its accounts on mercantile basis and computing loss or profit, as the case may be, at the end of the chit period in respect of chits terminating in a particular previous year, following completed contract method.

2.2. Before the assessing officer, the assessees claimed that the discount arose at a particular point of time when the prized chit amount was received and the discount was a statutory and contractual liability incurred by the subscriber as a consideration for obtaining the sum total of all the contributions by way of subscription in an accelerated manner. According to the assessees, the discount was not an amount paid in advance like rent or interest, but was a single amount giving rise to a single liability not only legally enforceable but also actually enforced by the Foreman by deducting it from the chit amount and by paying only the balance to the prized subscriber as the prized amount. The assessees further claimed that once the prized subscriber offered the highest bid, his liability for discount became crystallized, adjusted and totally discharged and the chit discount which was payable and adjusted against the bid amount leaving only the prized amount to be disbursed to the prized subscriber did not leave any scope for showing a part of the discount as an advance referable to the remaining period of the respective chit and it would be a misconception to call the discount amount as a time based liability and it would be legally untenable to dissect it on time basis. The assessees also contended that in mercantile system of accounting the liabilities were incurred irrespective of the date of payment whereas in the instant case, by virtue of the provisions of the Chit Funds Act and the agreement entered into between the Foreman and the assessees, the liability by way of discount arose in full measure at the moment the subscriber became a prized subscriber and it was a liability in praesenti and also a statutory liability which could not even be postponed by the act of the parties concerned.

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2.3. The Assessing Officer found that the chit dividend was a regular activity and received on a regular basis and the discount amount would run for the remaining period of the chit. The assessing officer rejected the method of accounting adopted by the assessees and taxed the dividend in the year of receipt and allowed chit loss on proportionate time basis by distributing over the remaining period subsequent to the bidding at the chit auction.

2.4. On appeal by the assessees, the Commissioner of Income-tax (Appeals), while rejecting the completed contract method, held that dividend is taxable in the year of receipt and chit loss is allowable as a deduction in the year of bid itself.

2.5. Aggrieved against the same, both the assessees and the Department went on appeals before the Income-tax Appellate Tribunal and the Tribunal, relying upon the instructions made by the Central Board of Direct Taxes dated 16.5.76 and also relying upon the decision of the Apex Court in Madras Industrial Investment Corpn. Ltd. Vs. Commissioner of Income-tax (225 ITR 802), allowed the department's appeal and dismissed the appeals preferred by the assessees.

2.6. Hence, the assessees have preferred the present appeals raising the following common questions of law:

a) Whether the Income tax Tribunal is right in law particularly in the light of S.5 and 145 of the Income tax Act, 1961, in rejecting the method of accounting adopted by the appellant under which income or loss as the case may be arises or accrues by netting dividend against chit loss, only at the end of the chit period of each chit group ?

b) Whether the Income-tax Tribunal is right in law in applying the principles of deferred expenditure to the appellant's case where there is no deferred benefit and concluding that chit discount should be allowed spreading it over the remaining period of the chit on proportionate basis ?

c) Whether the Income-tax Tribunal is right in law in not following the Central Board of Direct Taxes instruction dated 16.5.78 on the issue of taxability of dividend and allowance of chit loss as a deduction?

3. The submissions of the learned counsel appearing for the assessees are as follows:

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3.1. The completed contract method followed by the assessee is the most ideal one for recognizing the dividend income in a chit transaction. The assessees were adopting the completed contract method regularly and it was also accepted by the department during the previous assessments. Therefore, the accounting of dividend and chit loss arises only at the end of the termination of chit period and not earlier.

3.2. The measure of discount was not time based. The claim for adjustment of the discount against the chit dividend was allowable in the very year under appeal. The liability by way of discount arises in full measure the moment the subscriber becomes a prized subscriber and it is a statutory liability which could not even be postponed by the act of parties. If a business liability has definitely arisen in a particular accounting year, the deduction has to be allowed in the accounting year itself. The discount offered is a certain sum and the liability for deduction of discount which is an one time opportunity cost offered by a prized subscriber has to be allowed in full.

3.3. Learned counsel for the appellants/assessees also took us through the relevant sections of the Chit Funds Act, viz., 2(d), 2 (g), 2(h) and 2 (m).

3.4. The learned counsel further submitted that the decision of the Supreme Court in Madras Industrial Investment Corporation Ltd., v. CIT (225 ITR 802) dealing with the discount on debenture, is distinguishable on the facts of the present case, as in the said case, the difference between the face value and the actual amount realised from the customers was considered to be a discount on debenture and the said discount must be spread over the period of life of the debentures, whereas in this case the assessees took the chit at discounted value prior to the termination of the chit with agreement to continue to contribute the chit till it is formally terminated and therefore, the difference is obvious, that is, in the case of the former it is a case of receipt while in the case of latter, it is the amount paid followed by encashment of the chit at an early date with a promise to pay the remaining instalments.

4.1. On the other hand, Mrs.Pushya Sitaraman, learned senior standing counsel submitted that the chit dividend received during the relevant period of time should be measurable at the time of receipt and there was no reason to postpone this income till the termination of the chit by following the completed contract method.

4.2. It is further submitted that since the assessees would continue to receive dividend till the tenure of the chit and therefore, the discount also runs parallel to the earning of the

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dividend which should be allowed on a proportionate basis, that is, on a tenure basis to the extent it falls within the accounting period.

5. For better appreciation of the questions raised in the appeals, a reference to sections 2(d), 2(g), 2(h) and 2(m) of the Chit Funds Act, 1982 is inevitable, which read as follows:-

> 2.Definition.- In this Act, unless the context otherwise require,-
>
> (d) "chit amount" means the sum-total of the subscriptions payable by all the subscribers for any installment of a chit without any deduction of discount or otherwise;
>
> (g) "discount" means the sum of money or the quantity of grain which a prized subscriber is, under the terms of the chit agreement, required to forego and which is set apart under the said agreement to meet the expenses of running the chit or for distribution among the subscribers or for both;
>
> (h) "dividend" means the share of the subscriber in the amount of discount available under the chit agreement for rateable distribution among the subscribers at each installment of the chit;
>
> (m) "prize amount" means the difference between the chit amount and the document, and in the case of a fraction of a ticket means the difference between the chit amount and the discount proportionate to the fraction of the ticket, and when the prize amount is payable otherwise then in cash, and value of the prize amount shall be the value at the time when it becomes payable.

6.1. In the scheme of chit funds, every member agrees to pay a fixed amount on monthly basis for a fixed period. The face value of the chit will be equal to the product of the monthly subscription and the number of months. For example, if the monthly subscription is Rs.250/- and the duration of the chit is 40 months, then the face value of the chit will be Rs.10,000/-.

6.2. In the instant case, the appellant/assessees companies are conducting chit funds to which the respective assessee companies are themselves subscribers. As a result, the assessees earned commission and also dividend as subscribers under various chit fund schemes.

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6.3. When the chit is auctioned every month, the bidder takes the chit for an amount which is less than the face value of the chit. The difference between the face value and the auctioned value during every month is the gross dividend generated in that month. This amount of dividend gets distributed among all the members (subscribers) equally. The members (subscribers) need not pay the total monthly subscription and instead, they have to pay the monthly subscription after deducting the amount of dividend earned. The members who have taken the chit in auction have the liability to keep the contribution to the chit till the end of the chit period and the prized members would be getting dividend in future months also. In so far as discount, namely, the difference between the face value of the chit amount and the auctioned amount is concerned, the assessees have considered it as their bid loss and claimed the same as allowable during the year in which it occurred.

6.4. In this view of the matter, when the Revenue claimed the dividend as taxable in the relevant accounting year, the assessees claimed that the dividend is taxable only on the completion of the chit period. Similarly, while the Revenue claimed that the discount is allowable as business loss proportionately, the assessees claimed that the discount is allowable in the same accounting year in which it occurred.

7.1. The Andhra Pradesh High Court in Commissioner of Income-tax Vs. Kovur Textiles Ltd. (136 ITR 61) found that the assessee company subscribed to a chit fund by joining in a chit group and after paying few instalments, the assessee bid the chit and claimed the difference between the chit amount and the price for which it was bid as a business loss. On the factual backdrop, the Andhra Pradesh High Court held that the loss incurred by the assessee in the process of bidding the chit amount could be allowed as a business loss.

7.2. Of course, the Punjab and Haryana High Court in Soda Silicate and Chemical Works Vs. Commissioner of Income-tax (179 ITR 588) took a contra view that where the assessee secured a chit on discount and claimed deduction of discount amount while computing its assessable income, the loss incurred thereon was not incidental to the business and therefore, disallowed the assessee's claim during the year in question.

7.3. We are unable to agree with the decision of the Division Bench of Punjab and Haryana High Court in Soda Silicate and Chemical Works Vs. Commissioner of Income-tax case, cited supra. The Punjab and Haryana High Court held that the discount amount is not allowable as business loss on the ground that the transaction involved did not give rise to any income assessable to income-tax, nor any revenue loss in respect of which any deduction could be

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claimed. The judgment of the Punjab and Haryana High Court has no relevance to the facts of the present case, as, in this case, business loss occurred during the previous year relevant for the assessment year and the discount is found to be connected with the business activities of the assessees, whereas in the case before the Punjab and Haryana High Court, on facts, it was found that the discount is not connected with the business of the assessee. On the other hand, the facts of the present case are similar to that of the case before the Andhra Pradesh High Court, viz., Commissioner of Income-tax v. Kovur Textiles Ltd. (136 ITR 61) and hence, we agree with the view taken by the Andhra Pradesh High Court.

8.1. The Tribunal relied on the decision of the Supreme Court in MADRAS INDUSTRIAL INVESTMENT CORPORATION LTD. V. C.I.T. (225 ITR 802) and held that the dividend is taxable and discount is allowable both during the accounting year proportionately. In Madras Industrial Investment Corporation Case, cited supra, the assessee company issued debentures at a discount and it incurred a liability to pay a larger amount than what it had borrowed. The liability to pay the discounted amount over and above the amount received for the debentures is a liability which has been incurred by the company for the purposes of its business in order to generate funds for its business activities. Then, while deciding the question whether such a liability is an expenditure or not, the Apex Court held that the liability to pay discounted amount over and above the amount received for the debentures is a liability incurred by the company for the purposes of its business in order to generate funds for its business activities and therefore, it is an expenditure. The Apex Court also held that it is an expenditure deductible only proportionately during the period of assessment years.

8.2.1. The decision of the Apex Court in Madras Industrial Investment Corporation Case, as rightly pointed out by the learned counsel for the appellants/assessees, is distinguishable on the facts of the case.

8.2.2. The present case relates to the chit fund transaction. The chit is a kind of savings scheme. In a chit scheme, a specific number of individuals come together to pool a specific amount at periodic intervals. Usually, the number of individuals and the number of periods will be the same. At the end of each period, there will be an auction of the money. The members of the chit will participate in this auction for the pooled money during that interval. The bid amount will be divided by number of members and thus determining per head contribution during that period. Usually the discount, namely, the sum of money which the prized subscriber is required to forego, will continue to decrease over periods. The person getting money in the last period will receive the full scheme amount.

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8.2.3. On the other hand, the debenture is an instrument of debt executed by the company acknowledging its receipt to repay the same at a specified rate and also carrying interest. It is in sum and substance a certificate of loan or a bond evidencing the fact that the company is liable to pay a specified amount with interest. A debenture is unsecured in the sense that there are no liens or pledges on specific assets. It is however, secured by all properties not otherwise pledged. In the case of bankruptcy the debenture holders are considered general creditors. When a company issues debentures at a discount, the debenture holders are required to pay a lesser sum than the face value and the company incurs a liability to pay a larger amount than what it has borrowed, at a future date. The liability to pay the discounted amount over and above the amount received for the debentures is a liability which has been incurred by the company for the purposes of its business in order to generate funds for its business activities.

8.2.4. In so far as debenture is concerned, the benefit to be derived from the amount borrowed will continue till the debenture is redeemed and the liability is a continuing liability which should be spread over the period of the debentures. But, in a chit transaction, a member of the chit will forego the discount when he bids the chit. The discount amount varies in each period and it has no connection or relevance to the liability to pay future instalments. In other words, in chit transaction the discount is based on bid and the bid loss has no relevance to the liability for future instalments, whereas in the case of discount on debentures, it is not based on any bid loss, but it spreads over the period of life of the debentures. In the case of debentures, it is a case of receipt, while in the case of chit transaction, it is an amount paid followed by the encashment of chit amount at an early date with the promise to pay the remaining instalments. In this view of the matter, the decision of the Apex Court in MADRAS INDUSTRIAL INVESTMENT CORPORATION LTD. V. C.I.T. (225 ITR 802) is not applicable as in the instant case the discount arises out of a chit transaction, whereas the Apex Court dealt with the discount on the issue of debenture.

8.3. A Five Judge Bench of the Kerala High Court in JANARDHANA MALLAN v. GANGADHARAN (AIR 1983 Kerala 178) held that on entering into the chitty agreement a debt is not incurred by the subscriber for the amount of all the future instalments, but it is a promise to discharge the contractual obligation, whether the prize is drawn or not or the prize amount is received or not. It is also held that but for such obligation there will be no difference between the liability of the prized subscriber and the non-prized subscriber and both arise out of the same contract and that since both profit and loss arise simultaneously on the date of prize drawn itself, the

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question of incurring fresh obligation to pay future subscription does not arise. Therefore, the subscriber is entitled to deduction of discount as business loss in the accounting year in which it occurred.

9.1. As observed earlier, in the chit transaction there is only a promise on the part of the assessees to discharge the contractual obligation. Further, the assessee companies following mercantile system of accounting as statutorily required under the Companies Act, have to account for its income or loss as per the mercantile system of accounting and not otherwise. In other words, the income or loss of the assessees accruing during the relevant accounting year has to be considered for the purpose of income-tax assessment. When the assessees are in the business of subscribing to chits and deriving income out of it during a particular year, it is not possible or permissible to defer its assessability till the completion of the entire cycle of the chit.

9.2. At this juncture, it is apt to refer to Sections 5 and 145 of the Income-tax Act.

> "5.Scope of total income: (1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which—
>
> (a) is received or is deemed to be received in India in such year by or on behalf of such person; or
>
> (b) accrues or arises or is deemed to accrue or arise to him in India during such year ; or
>
> (c) accrues or arises to him outside India during such year :
>
> Provided that, in the case of a person not ordinarily resident in India within the meaning of sub-section (6) of section 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India.
>
> (2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—
>
> (a) is received or is deemed to be received in India in such year by or on behalf of such person; or
>
> (b) accrues or arises or is deemed to accrue or arise to him in India during such year.
>
> Explanation 1.—Income accruing or arising outside India shall not be deemed to be received in India within the

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meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.

Explanation 2.—For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India."

"145. Method of accounting - (1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assessees or in respect of any class of income.

(3) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) or accounting standards as notified under sub-section (2), have not been regularly followed by the assessee, the Assessing Officer may make an assessment in the manner provided in section 144."

9.3. A conjoint reading of the above provisions of law makes it clear that all income received or deemed to be received or accrues or arises during the previous year shall form part of the total income of the assessee and such income shall be computed in accordance with the accounting system which the assessee is regularly following. Here, on the facts of the case, the authorities have found that the assessees are following mercantile system of accounting. The mercantile system of accounting means, as discussed in Shiva Prasad Gupta v. C.I.T. (AIR 1929 All. 823), the amounts that have become recoverable are shown as the income actually received and the liabilities incurred are shown as amounts actually disbursed in any particular year. Therefore, when the assessees are following mercantile system of accounting, in which entries are posted in the books of account on the date of the transaction, that is, on the date on which rights accrue or liabilities are incurred irrespective of the date of payment, they have to account for their income or loss as per the mercantile system of accounting and not otherwise. Therefore, as rightly found

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by the Commissioner of income-tax (Appeals), the income derived during a particular previous year by way of chit dividend has to be reckoned and assessed as income of that year following the principles of mercantile/accrual system of accounting, particularly when the assessees are companies following the mercantile system of accounting.

10.1. The chit transaction is governed by the provisions of the Chit Funds Act. In view of the non obstante clause found in section 3 of the Chit Funds Act, 1982, namely,

> "3. Act to override other laws, memorandum, articles, etc.- Save as otherwise expressly provided in this Act,-
> (a) the provisions of this Act shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force or in the memorandum or articles of association or bye-laws or in any agreement or resolution whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Act; and
> (b) any provision contained in the memorandum, articles, bye-laws, agreement or resolution aforesaid, shall, to the extent to which it is repugnant to the provisions of this Act, become or be void, as the case may be",

the definitions of the expressions, discount, dividend, prize amount, as extracted above, will prevail over the similar definitions as found in the Income-tax Act, because a non obstante clause is generally appended to a section with a view to give the enacting part of the section in case of conflict, an overriding effect over the provision in the same or other Act mentioned in the non obstante clause (vide: State of Bihar v. Bihar Rajya M.S.E.S.K.K.Mahasangh (2005) 9 SCC 129). Therefore the discount is not an interest payable on the prized amount, but it is a loss.

10.2. As already observed, in chit transaction there is no correlation between the discount amount and the future instalments. Further, the measure of future instalments does not depend upon the prized amount or the discount, nor the discount is an expenditure to be incurred in future. The discount is not a deferred expenditure for which payment has been made, or a liability incurred, but the discount is carried forward on the presumption that it will be of benefit over a specific period. In the chit transaction, there is no deferred benefit, which is construed to mean the benefit deferred to a year subsequent to the accounting year and hence, the question of deferred expenditure does not arise.

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10.3. That apart, the provisions of the Chit Funds Act require the prized subscriber to furnish security for future instalments. Therefore, neither the enforceability of the right to receive the dividend, nor that of the obligation to pay the discount could be deferred and both accrued instantaneously. Hence, the discount is allowable in the very same year of accrual. In this view of the matter, the dividend has to be taxed in the year of accrual; so also, the discount has to be allowed in full in the year of accrual itself. The Appellate Tribunal is right in rejecting the completed contract method of accounting adopted by the assessees and at the same time, it is not correct in holding that the discount should be allowed spreading it over the remaining period of the chit on a proportionate basis.

11.1. For the foregoing reasons, we hold that the dividend income has to be taxed on the basis of its accrual and accordingly, we answer the first question in favour of the Revenue and against the assessee.

11.2. As regards the second question, we hold that the the discount loss claimed should be allowed in the year of its accrual and hence, we answer the second question in favour of the assessee and against the Revenue.

11.3. With regard to the third question, since the question is academic in nature, we need not go into the same.

12. In the result, the first question of law is answered in favour of the Revenue and against the assessee and the second question of law is answered against the Revenue and in favour of the assessee. The third question being academic in nature is not answered. The appeals are ordered accordingly. No costs.

sra/na

Sd/
Asst.Registrar

/true copy/

Sub Asst.Registrar

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To

1.The Assistant Registrar,
Income Tax Appellate Tribunal Madras Bench "B".

2.The Asst Registrar,
Income Tax Appellate Tribunal Madras A Bench

3. The Asst Commissioner of Income Tax
Central Circle II (6), Madras.

4. The Asst Commissioner of Income Tax
Central Circle I(4) Chennai 34.

5. The The Deputy Commissioner of Income Tax
Special Range IV Chennai 34.

6. The Assistant Commissioner of Income Tax
Central Circle II (6), Chennai 34.

7. The Assistant Commissioner of Income Tax
company Circle IV(1) Chennai 6.

8. The Commissioner of IT
Central II Chennai

9. The Commissioner of IT
Company Circle Chennai 34.

10. The Jt Commissioner of IT
Spl Ranger IV Chennai 34.

11. The Asst Registrar Income Tax
Appellate Tribunal Rajaji Bhavan
III Floor, Besant Nagar, Chennai 90.

+ 3ccs to Mr. V. D. Gopal, Advocate SR No. 25698

+ 8 ccs to M/s. Pushya sitaraman, Advocate SR Nos.25775, 25776, 25763, 25764, 25767, 25765, 25766, 25768

BV(CO)
SR/28.9.2006

T.C.(A) Nos.76 to 86,
105, 129 to 133 of 2003
and 287 to 290, 322 to 328
and 459 to 463 of 2006

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